

No. 12856

**In the United States Court of Appeals
for the Ninth Circuit**

OREGON CHROME MINES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES**

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The findings of fact (R. 21-26), and opinion (R. 26-32) of the Tax Court, together with a dissenting opinion (R. 32-34) are reported at 15 T. C. 389.

JURISDICTION

The petition for review (R. 36-37), involves corporate excess profits tax for the taxable year 1944, in the amount of \$15,085.16. The notice of deficiency was mailed to the taxpayer on February 18, 1948. (R. 12-16.) The taxpayer filed a petition for redetermination with the Tax Court on May 17, 1948 (R. 3, 5-11), under the provisions of Section 272 of the Internal Revenue Code. The decision of the Tax Court sustaining the Commissioner's deficiency determination with respect

to the issue raised on review was entered on November 30, 1950. (R. 34-35.) The case is brought to this Court by a petition for review filed by the taxpayer on January 22, 1951 (R. 36-37), pursuant to the provisions of Section 1141 (a), Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

The taxpayer, as a lessor of a chrome mine, received royalty income from the lessee who operated the mine pursuant to a leasing agreement.

The question is whether the Tax Court erred in holding that such royalty income was not exempt from excess profits tax under Code Section 731 since the taxpayer, as lessor, was not engaged in the mining of chromite within the meaning of that section.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 731 [as added by Sec. 226 (a), Revenue Act of 1942, c. 619, 56 Stat. 798]. CORPORATIONS ENGAGED IN MINING OF STRATEGIC MINERALS

In the case of any domestic corporation engaged in the mining of * * * chromite, * * * the portion of the adjusted excess profits net income attributable to such mining in the United States shall be exempt from the tax imposed by this subchapter. The tax on the remaining portion of such adjusted excess profits net income shall be an amount which bears the same ratio to the tax computed without regard to this section as such remaining portion bears to the entire adjusted excess profits net income.

(26 U. S. C. 1946 ed., Sec. 731.)

STATEMENT

A portion of the facts in this case were stipulated. The findings of the Tax Court may be summarized as follows:

During the First World War, the Agnes mining claims, located in Josephine County, Oregon (known as Agnes No. 1 to Agnes No. 7, inclusive), had produced approximately 5,000 tons of chrome ore. Since chrome ore is normally imported into this country, the prior owners allowed the claims to lapse and to revert to the Government some time after the conclusion of the First World War. (R. 22.)

Prior to June 24, 1941, title to the Agnes mining claims was held by Sig Dilsheimer for the benefit of himself and other persons who had contributed sums of money with the understanding that a corporation would be formed in which they would receive stock interests in return for such advances. Examination of the abandoned mining site had convinced them that there was a reasonable prospect of getting at least 5,000 more tons of chrome from these mining properties. (R. 22.)

The taxpayer corporation was organized on June 13, 1941, under the laws of the State of Oregon. Its articles of incorporation authorized the taxpayer to engage in the mining, buying and selling of all kinds of ores, metals, and minerals. It was also empowered to acquire and dispose of mining claims and property. (R. 21-22.)

On June 24, 1941, Dilsheimer conveyed the Agnes claims to the taxpayer in return for 47,997 shares of its capital stock, a portion of which he then distributed to those persons who had contributed funds prior to the taxpayer's incorporation. The remaining three

shares of taxpayer's stock were issued to Max Kreuger, J. C. Haas, and Garfield Voget, as qualifying shares and as part of the transaction whereby taxpayer acquired the mining claims. (R. 22-23.)

On July 2, 1941, taxpayer borrowed \$5,000 from Voget to use for operating expenses in developing the Agnes Mining claims. Prior to April 12, 1942, taxpayer completed several hundred feet of tunnel work and engaged in raising, drifting and cross-cutting to find ore. (R. 23.)

On April 14, 1942, taxpayer entered into a written lease with William S. Robertson by which the Agnes mining claims were leased to Robertson. (R. 23.)

The terms of the lease, in part, provided as follows (R. 23-25):

The lessor agrees:

1. Oregon Chrome Mines, Inc., leases to William S. Robertson the above claims for a period of two years from date with an option of two additional years if the recovery from said claims is reasonably successful during the first two years.

2. Oregon Chrome Mines, Inc., agrees that each year it will file with the proper authorities proof of labor for the past year so that title to said claims will remain in the corporation and locations to said claims be kept valid.

3. Oregon Chrome Mines, Inc., will keep its corporate franchise intact, keep its corporate taxes paid, and will pay all governmental and state charges against said claims.

The lessee agrees:

1. To furnish such equipment, tools, and machinery, and labor as will be necessary to work said claims, and to explore said ground to determine if the said land contains chrome ore, and if the said claims contain chrome ore he agrees to mine said claims and to ship said ore to market and to sell same to his best advantage.

2. The lessee, above named, shall open, use, and work said mines as is usual and customary in the skillful and proper mining operations of similar character, and shall perform or cause to be performed at least 1,000 man hours labor at said claims, beginning not later than May 20, 1942, and ending not later than August 20, 1942, and after he has expended said hours labor on said claims he shall have the right to cancel this lease by giving ten days' written notice to the lessor and then he shall have the right to forthwith remove any and all equipment, tools, and machinery that he has placed on said claims.

3. The lessee, above named, shall pay all expenses of operation, including labor, and shall pay all state and governmental taxes in connection with his own operation. He shall carry state industrial accident insurance.

4. The lessee, above named, agrees to pay the lessor as rent and royalty for the use and depletion of said claims and the taking of said chrome ore one-fifth or 20 per cent of any and all amounts he shall receive from sale of said ore. This 20 per cent to be a gross royalty and from 80 per cent of the amount he shall receive from the sale of said ore he shall pay for the expense of operation. In other words, the lessee is to pay the lessor a 20 per cent gross royalty.

The lessee agrees to seasonably sell the ore that he has mined and to furnish the lessor a duplicate statement of the amount received by him for the sale of said ore. Ten days after he has received his pay for the ore he agrees to pay one-fifth thereof or a 20 per cent to the lessor.

The lease, which was subsequently modified (the modification relating only to the gross royalty payable) was in effect during the taxable year 1944. Subsequent to the execution of the lease, and during the taxable year, the taxpayer's income consisted entirely of royalty payments received under the lease agreement. After the

lease was executed, the taxpayer did not, either directly or indirectly, take part in completing the development of these mining properties, or in the extraction and marketing of chrome. (R. 25.)

The taxpayer occasionally made inquiries concerning the purchase of other mining properties, but at the close of 1944 had not completed any deals for the acquisition of additional mining claims. In July, 1944, the taxpayer did authorize its attorney to purchase some previously mined chrome ore which he had been dickering for on his own, and a check for \$3,000 was issued to him for that purpose. (R. 26.)

The ore extracted from the Agnes mining claims was of a very high grade and during the period under consideration constituted one of the largest sources of high grade chrome ore in the United States. (R. 26.)

In 1944, in reply to an inquiry of the taxpayer, the Commissioner of Internal Revenue advised that it was not considered that the taxpayer was a domestic corporation engaged in mining and that its adjusted excess profits net income was not exempt from the excess profits tax under Section 731 of the Internal Revenue Code. (R. 26.)

The Tax Court specifically found that the taxpayer "was not 'engaged in the mining' of chromite within the meaning of Section 731 of the Internal Revenue Code" (R. 26), and it concluded, accordingly, that it was not entitled to the excess profits tax exemption contained in that section of the Code. (R. 26-32.)

Judge Arundel wrote a dissenting opinion, in which Judges Van Fossan, Johnson and Tietjens agreed. (R. 32-34.)

SUMMARY OF ARGUMENT

The Tax Court correctly held that the taxpayer was not exempt from excess profits tax under Section 731 of the Internal Revenue Code with respect to the royalty

income which it received as the lessor of a chrome mine. Section 731 is applicable only to a corporation "engaged in the mining of" certain specified minerals. The statute, by its plain language, is concerned only with corporations engaged in making or working a mine, and deriving income therefrom. An ordinary lessor, such as the taxpayer in this case, is clearly not engaged in doing either.

In addition to the plain language of the statute, its history and purpose are consistent only with the result reached by the Tax Court; they precluded the notion that this extraordinary tax exemption was intended to be available to a corporation which was merely the passive recipient of royalty income during the taxable year.

The fact that the taxpayer, in a previous year, had done some work in connection with the mine, does not qualify it for exemption during the taxable year. Its income during the taxable year was not derived from such activity and the taxpayer was not, in any conceivable way, engaged in mining during the taxable period involved.

ARGUMENT

The Taxpayer Was Not Engaged in Mining During the Taxable Year, and Its Royalty Income Was Not Exempt from Excess Profits Tax under Section 731, Internal Revenue Code

The narrow issue in this case is whether the royalty income received by the taxpayer, as the lessor of a chrome mine, is subject to the excess profits tax, as the Tax Court ruled, or whether, as the taxpayer claims, that income is completely exempt from the tax under Section 731, Internal Revenue Code, *supra*. The Tax Court, we believe, was altogether right in holding that the statutory exemption does not extend to a corporation which is only the passive recipient of royalties under a lease, and which does not perform any active function during the taxable year relating to the dis-

covery or severance of the minerals in place. Such a corporation is not "engaged in the mining" of strategic minerals, and the statute grants it no exemption.

In *Crane v. Commissioner*, 331 U. S. 1, 6, the Supreme Court observed that "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses." See also *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 560. In such circumstances, it is "probably not necessary to go beyond the plain words of * * * [the statute] in search of the legislative meaning." *Helvering v. Northwest Steel Mills*, 311 U. S. 46, 49.

The plain, ordinary meaning of the statute here, as the Tax Court aptly pointed out (R. 29), covers only the active process of making mines and removing the minerals from their source. By limiting the exemption to corporations engaged in mining, Congress clearly intended that Section 731 should only apply to corporations deriving income from working a mine. Thus, the term "mining" is defined by Webster's International Dictionary (Second ed.) as the "Act or business of making or of working mines." The same source defines a "mining partnership" as an association of individuals "* * * when they actually engage in working a mining claim * * *." See *Rucks v. Burch*, 138 Tex. 79, holding that there is no mining partnership unless there is a joint operation of the property.

A lessor which derives its income solely from the receipt of royalty payments and which performs no other mining activity during the taxable year could scarcely be described as engaged in working a mine or as engaged in the mining of minerals. Giving the statute the meaning which it would have in ordinary parlance accordingly, inevitably leads to the conclusion that the taxpayer's income was not intended to be exempt from the excess profits tax.

We need scarcely point out, moreover, that since Section 731 creates an exemption from tax, it must be strictly construed. *New Colonial Co. v. Helvering*, 292 U. S. 435, 440; *White v. United States*, 305 U. S. 281, 292; *Deputy v. duPont*, 308 U. S. 488, 493; *Helvering v. Northwest Steel Mills, supra*, p. 49; *Commissioner v. Jacobson*, 336 U. S. 28, 49. The taxpayer is not entitled to claim the exemption unless the statute is applicable by its clear terms; the exemption cannot rest on "doubt," "ambiguity" or "mere implications." *United States v. Steward*, 311 U. S. 60, 71. We think it apparent, on the face of the statute, that the taxpayer here cannot meet these conditions.

The history and purpose of the statute, moreover, are persuasive that Congress used the term "mining" in its ordinary sense, and did not intend that the exemption should be applicable to corporations not actively engaged in working a mine. A corresponding section was added to the Code when the excess profits tax was imposed by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974. It had its origin in an amendment adopted by the Senate and, as it passed the Senate, the amendment would have added Section 730 to the Code as follows (H. R. 10413, 76th Cong., 3d Sess.):

SEC. 730. INCOME FROM MINING OPERATIONS.

Income derived from the mining reduction or beneficiation of tungsten, quicksilver, manganese, platinum, antimony, chromite, and tin, or the ores and material containing such metals, shall not be subject to the excess-profits tax provided for in this Act.

While the explanation given in support of the amendment by Senator Pittman (86 Cong. Record, Part 11, pp. 12347-12348) did not indicate the precise scope of the section, it should be noted that the amendment re-

lated to "income derived" from the enumerated functions; thus, although such does not seem to have been the express object of the sponsor of the amendment, it might have been possible for taxpayers to urge that it was intended to extend the exemption to any recipient of such income.

This possibility, however, was removed when the amendment was altered in conference so as to be Section 731 of the Code and to be similar to Section 731 of the Code as it relates to the taxable year here in question. For, as finally enacted, the insertion of the requirement that, to claim the exemption, the corporation must be "engaged in mining" would seem to have been designed to dispel any notion that a recipient of royalty income could claim the exemption merely because the income had its origin in the mining activities conducted by another taxpayer. Thus, in explaining the changes made by the conferees, Senator Harrison said (86 Cong. Record, Part 12, p. 12919) "we were able to work out a compromise *confining the exemption to the mining* of such metals by domestic corporations * * *." (Italics supplied.) The emphasis, it should be noted, was in relation to an active mining function, not to a passive collection of royalties.

The purpose of Section 731, moreover, is such that there would have been no cogent necessity impelling Congress to extend the tax exemption to corporations which merely receive royalties and which are not themselves currently engaged in mining activities. Section 731, which was repealed in 1941,¹ re-enacted with retroactive effect in 1942,² and amended to include additional minerals in 1943,³ had the obvious purpose of encouraging the production of these critical minerals.

¹ Section 205, Revenue Act of 1941, c. 412, 55 Stat. 687.

² Section 226, Revenue Act of 1942, c. 619, 56 Stat. 798.

³ Section 207, Revenue Act of 1943, c. 63, 58 Stat. 21.

See H. Conference Rep. No. 3002, 76th Cong., 3d Sess., pp. 55-56 (1940-2 Cum. Bull. 548, 559-560); S. Rep. No. 331, 77th Cong., 2d Sess., p. 211 (1942-2 Cum. Bull. 604, 658-659); H. Conference Rep. No. 2586, 77th Cong., 1st Sess., p. 64 (1942-2 Cum. Bull. 701, 722); H. Rep. No. 871, 78th Cong., 1st Sess., p. 58 (1944 Cum. Bull. 901, 944); S. Rep. No. 627, 78th Cong., 1st Sess., pp. 4-75 (1944 Cum. Bull. 973, 1027). Such encouragement was offered by way of an extraordinary tax advantage to mine operators who risked their capital in an uncertain venture. Such an additional incentive, however, was not necessary in case of lease owners which incurred no new capital risks or which did not undertake a new capital investment in the actual working of mines. So long as an operator would be willing to invest its capital and undertakes to work the mine, the lease owner, presumably, would be willing to accept the lease royalty payments, even though no extra tax advantage was offered with respect to such royalty payments. It is significant, moreover, that in none of the hearings, debates or committee reports was it ever suggested that this extraordinary tax exemption should be made available to corporations which merely received royalty income and which did not participate in the risk taking which is involved when a lessee corporation engages in the actual extraction process which constitutes the working of a mine. See Seidman's Legislative History of Excess Profits Tax Laws (1946-1947), pp. 12-216.

This is not to overlook the general impact of the excess profits tax on those corporations possessing an interest in mineral deposits (including lessors) which accelerated production from limited natural deposits in response to the country's war need. Relief from excess profits taxation which would otherwise have been imposed on the income from such accelerated production

was granted by Section 735 of the Code (in conjunction with Code Section 711 (a)(1) (I) and (a) (2) (K)) which was calculated to measure the amount of the relief by the extent to which production was accelerated. Even here, however, an express statutory amendment was needed to extend the relief to lessors and their royalty income.⁴ Section 731, however, with the complete exemption which it afforded to corporations engaged in mining was plainly designed to accomplish an altogether different objective, an objective which, as we have seen, would not encompass taxpayers which were the passive recipients of royalty payments.

The taxpayer points (Br. 6-7) to the stipulated fact (R. 23) that it had, in 1942, completed several hundred feet of tunnel work and had engaged in raising, drifting and cross-cutting to find ore. This, however, can have no possible significance to the issue involved here. Such activity had ceased when the lease was executed and the taxpayer performed no such function during the taxable year. During the taxable year, the taxpayer was not a corporation engaged in mining and its income was not derived from its mining activities. Furthermore, as the Tax Court pointed out (R. 30-31), the claims had previously been worked, and there is no evidence that this limited activity of the taxpayer in 1942 resulted in the discovery of any ore. Furthermore, the taxpayer took no further steps toward an active participation in mining operations there or elsewhere, so that the Tax Court was compelled to conclude that (R. 31) "in 1944 petitioner [taxpayer] was not engaged in discovering deposits of chrome ore, building mines, extracting ore or treating same." It clearly follows that the taxpayer was not engaged in "mining," as required by the statute. While the taxpayer makes the contrary contention (Br. 6), there is nothing in the

⁴ Section 208, Revenue Act of 1943, *supra*.

statute to extend the exemption to a corporation which may have been engaged in mining in some prior year, but which is not so engaged during the taxable year and which derives income from someone else's mining during the taxable year.

Finally, the taxpayer's reliance (Br. 7-8) on the ruling of the Committee on Appeals and Review, A.R.R. 6011, III-1 Cum. Bull. 377 (1924), with respect to the somewhat similar statutory language which was contained in Section 304 (c) of the Revenue Act of 1921, c. 136, 42 Stat. 227, is entirely misplaced. The situation to which the ruling was addressed was altogether different from that of this case. There, under the "tribute lease system," the taxpayer owned all the large tools used in the extraction of the ore, it exercised general supervision over the mining operations, it furnished the compressed air used in the mining operations, and did all the hoisting and hauling of the ore. All the ore was sold in the name of the taxpayer there, and the individual miners or group of miners, who were assigned particular drifts or portions of drifts to work, were compensated in accordance with the ore which they produced and the gold content of such ore. The taxpayer there, in a very real sense, was engaged in mining, the work being carried out for it by individual miners; the "tribute" leases there were somewhat similar to the "split check" leases involved in *Cresson Consolidated Gold Mining & Milling Co. v. Commissioner*, 11 T.C. 192. In the present case, with its ordinary leasing arrangement, the lessee was engaged in its own mining activities and the taxpayer cannot be considered to have been so engaged, even vicariously.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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MAY, 1951.